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The court thereupon went into a consideration of the cases on the merits, and being unable to accept the construction adopted by the Michigan court of the ordinances referred to above, it was of the opinion that the decisions reached by the State court could have been reached only by giving effect to the subsequent acts of the State legislature which made the annexed territory subject to the ordinances of the city, and thereby impaired the obligation of the contracts between the suburban lines and the villages and townships which granted the franchises. Justice CLARKE rendered a dissenting opinion in which Justice BRANDEIS concurred. These justices considered that "the passing of the valid extension act merely created a situation under which the implied condition *existing in the fare contract from beginning*, finds an application in the new territory. This is giving effect not to the terms of the act of the legislature, but to the terms of the contract with the city, and the most that can be said against the decision of the Supreme Court of Michigan is that it gives an erroneous construction of the contract." But this does not give rise to a Federal question within the rule of *Cross Lake Club v. Louisiana*, *supra*. W. L. O.

THE RIGHT TO RESCIND STOCK-DIVIDENDS ALREADY DECLARED.—The rule that cash dividends, once declared and published, become debts, irrevocable and absolutely due the shareholder, is so well-established as to hardly merit discussion. 7 COOK, CORPORATIONS, §541; 5 TAYLOR, CORPORATIONS, §568; MACHEN, MODERN LAW OF CORPORATIONS, §1358; MORAWETZ, CORPORATIONS, §445; CLARK & MARSHALL, PRIVATE CORPORATIONS, §517d. But in the recent case of *Staats v. Biograph Co.*, 236 Fed. 454 (C. C. A. 1916), the same question is raised as to stock dividends.

The corporation was capitalized for \$2,000,000 with all but \$1,000 of this stock outstanding, and for over a year there had been a surplus each month of over \$1,000,000 though there was a regular annual dividend of 12%. At this stage the directors declared and published a scrip dividend of 50% of the outstanding capital to be paid for in stock or cash at the option of the directors. Before any scrip was actually issued the European war broke out and the directors, having well-grounded apprehensions as to the effect of the war on their business, voted to rescind the dividend. The plaintiff was a shareholder and sought to collect the dividend on his shares in the present action. The court affirmed the right of the directors to rescind the dividend and denied the plaintiff any recovery.

The court recognized the prevailing doctrine as to *cash* dividends, but excepted stock dividends from the rule. The only authorities cited to support the distinction were *Terry v. Eagle Lock Co.*, 47 Conn. 141, a dictum in *Dock v. Schlichter Jute Cordage Co.*, 167 Pa. 370, and MACHEN, MODERN LAW OF CORPORATIONS, §601. As the *Cordage Company* case is not in point and MACHEN cites *Terry v. Eagle Lock Co.* as his sole authority, we may consider that case alone. Doing so we find that the decision was based squarely on the laches of the plaintiff. Inasmuch as the case seems to be the only one in which the subject of the present discussion has been raised prior to

the instant case we will disregard that matter and consider the dicta which form the exclusive basis for the decision in *Staats v. Biograph Co.* After first recognizing the general rule as to cash dividends CARPENTER, J. proceeds to distinguish stock dividends from cash dividends in this relation on two grounds: first, the formalities intervening between the declaration of the dividend and the actual issue of the stock (stating that the whole matter is in fieri until the stock is actually issued); and, secondly, "such dividends do not materially affect the value of the stock. * * * It does not add to his (the shareholder's) ready cash, but it changes the form of his investment by increasing the number of his shares, thereby diminishing the value of each share, leaving the aggregate value of his stock the same. It is of no special importance whether the value be divided into few or many shares." The first point is not much dwelt on as it is too readily answered by pointing out that formalities also intervene before a cash dividend can become cash after it is merely declared, and that saying that it is "in fieri" is begging the question. Moreover, in *Terry v. Eagle Lock Co.* it was necessary that the stock issue be authorized by vote of the shareholders, while in the instant case the directors had authority in themselves to issue stock under the circumstances. The second ground has been riddled in the cases dealing with the respective rights of life-tenant and remainderman to the dividends on stock devised to them. It is the fallacious basis of the so-called "Massachusetts Rule" which, though adopted by the United States Supreme Court in *Gibbons v. Mahon*, 136 U. S. 549, has been repudiated in practically every state in the Union where the question has arisen, except Massachusetts, Illinois, Rhode Island, and Georgia, the last-named being constrained by statute. 7 COOK, CORPORATIONS, §555. LORD ELDON, in *Paris v. Paris*, 10 Ves. 185, says: "As to the distinction between stock and money, that is too thin; and if the law is that this extraordinary profit (50% stock dividend), if given in the shape of stock shall be considered capital, it must be capital if given as money." The logical framework of the doctrine quoted from *Terry v. Eagle Lock Co.* (which is sedulously followed by the court in the instant case) has been completely shattered by the masterly opinions of O'BRIEN, J., in *McLouth v. Hunt*, 154 N. Y. 179, and MARSHALL, J., in *Soehnlein v. Soehnlein*, 146 Wis. 330, as well as such typical cases as *Earp's Appeal*, 28 Pa. St. 368; *Ross' Appeal*, 83 Pa. St. 264; *Hite v. Hite*, 93 Ky. 257; *Thomas v. Gregg*, 78 Md. 545; *Pritchitt v. Nashville Trust Co.*, 96 Tenn. 472, and *People v. Glynn*, 114 N. Y. Supp. 460.

But in *Soehnlein v. Soehnlein*, supra, MARSHALL, J. says: "Little or no benefit can be derived from an extensive discussion of mere case law. The better way is to discover the essential principle involved, if that can be done, and for a rule, trace that principle to a logical result." Refer to the argument quoted from *Terry v. Eagle Lock Co.* and relied on in the instant case as the sole basis for making a different rule for stock dividends than for cash dividends. Is the right to a stock-dividend a mere "nominal right"? Why, then, the hundreds of expensive litigations between life-tenants and remaindermen to secure such dividends? Why was the instant suit brought? Why do our eminent financiers consider it worth while to cut their juicy

"melons," often without any vestige of surplus, if they be such unsubstantial fruit? A mere "nominal right" will hardly occasion such lavish expenditure of effort and treasure in this work-a-day world! Is it true that when the stock of a corporation having a capital of \$1,000,000 and a surplus of \$1,000,000 is increased to \$2,000,000 and the additional \$1,000,000 in stock distributed pro rata among its shareholders, that the par value of its shares drops to 50 or the market value from 200 to 100? We all know that is not true. The par value remains the same; the market value is controlled, as before, by earning power, value of control and the various currents of the market. The "nominal value" theory is pure mathematics; it has no place in the world of reality.

A stock-dividend declared out of surplus is *not* a mere dilution of stock; it does *not* confer a mere nominal right upon the shareholder. It is true that the property of the corporation is not increased or diminished by such a dividend. But its liabilities are increased pro tanto, and this liability is to the existing shareholders. It is a debt to the shareholder to the full extent that the cash dividend is a debt. The vice in the "nominal value" theory is that its proponents have identified the corporation and its shareholders in a relation where their rights and liabilities are separate, distinct and, to a certain degree, even inimical.

The instant case was a hard one for the corporation. The circumstances warranting the revocation of the dividend as a matter of business policy were so strong that the court was evidently impressed thereby. But these considerations of business policy would weigh even more heavily against the enforcement of a claim for a declared cash dividend. Indeed, the scrip was to be optional in form and the court allowed the choice of the stock-dividend as the least threatening horn of the dilemma, under the rule of *Robinson v. Robinson*. We regret that the grounds for this decision were not more carefully considered.

E. B. H.